Supreme Court, U.S.
FILED
NOV 25 1992
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92-1282

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

R.E. LUSTER, BERNARD F. ARENAS, III, DAVID K. CARGILL, ELMER V. CLAPS, JAMES P. COLE, DAVID E. DODRILL, DR. JOHN DRAMMIS, JR., DONALD F. and MARGARET M. GARRETT, RICHARD W. and RUTH M. HAACK, BRADLEY O. HOLM, L. I. INVESTMENT CLUB TRUST #3, DR. READ LEWIN, DR. BARRY J. and LINDA L. KRAYNACK, WOODROW S. PATTERSON, KENNETH L. SALSMAN, REBECCA THOMPSON, THEODORE R. THOMPSON, PAUL TILLOTSON, GEORGE and VIRGINIA L. UDALL, CHARLES D. WARREN, B.E. WEBB, FRANK L. WEY, and JOHN V. ZEMAN,

Petitioners,

v.

WALTER HUMBERT CUSHMAN, III,

Respondent.

On Writ Of Certiorari To
The United States Court Of Appeals
For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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36 pp

QUESTIONS PRESENTED FOR REVIEW

Whether the principle of *res judicata* applies to a bankruptcy court's discharge of the liability of a nondebtor?

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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

R.E. Luster, Bernard F. Arenas, III, Elmer V. Claps, James P. Cole, David E. Dodrill, Dr. John Drammis, Jr., Donald F. and Margaret M. Garrett, Richard W. and Ruth M. Haack, Bradley O. Holm, L. I. Investment Club Trust #3, Dr. Read Lewin, Dr. Barry J. and Linda L. Kraynack, Woodrow S. Patterson, Kenneth L. Salsman, Rebecca Thompson, Theodore R. Thompson, Paul Tillotson, George and Virginia L. Udall, Charles D. Warren, B. E. Webb, Frank L. Wey and John V. Zeman,

Petitioners,

v.

Walter Humbert Cushman, III,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

To The Honorable, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

R.E. Luster, et al., the petitioners herein, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above entitled case on August 27, 1992.

OPINIONS BELOW

The per curiam opinion of the Court of Appeals (Jones, Weiner and Walter, Circuit Judges) is unreported and is reproduced in Appendix A. The opinions of the United States District Court for the Northern District of Texas, Dallas Division, (Maloney, District Judge) and of the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, (Felsenthal, Bankruptcy Judge) are reproduced in Appendix B and C. The judgment of the United States District Court for the Western District of Texas, Midland-Odessa Division, (Bunton, District Judge) is reproduced in Appendix D.

JURISDICTION

The judgment of the Court of Appeals was entered on August 27, 1992. This Petition for Writ of Certiorari is filed within 90 days of that date.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 524(e) provides in part:

> "(e) ... discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

11 U.S.C. § 523(a) provides in part:

> "A discharge under ... this title does not discharge an individual debtor from any debt ... for money... obtained by ... false pretenses, a false representation, or actual fraud..."

11 U.S.C. § 1141(d) provides in part:

> "The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title."

STATEMENT OF THE CASE

R. E. Luster and 21 other similarly situated judgment creditors of Walter Humbert Cushman, III brought a dischargeability complaint in bankruptcy pursuant to Title 11 U.S.C. § 523(a)(2)(A) seeking to determine the dischargeability of a judgment against Cushman for fraud committed in violation of federal securities laws. Earlier the Luster group had invested $404,909.73 in an oil and gas drilling venture promoted by Walter Humbert Cushman, III utilizing various operating names, one of which was Knightsbridge Petroleum Corporation. Upon learning that Cushman was a convicted felon who had previously been incarcerated for federal mail and wire fraud and that the oil and gas drilling venture was bogus and a fraudulent scheme,

they filed suit against a multitude of individuals and entities involved in the scheme alleging violations of federal securities laws. They eventually obtained service of citation on Walter Humbert Cushman, III individually. Service was never obtained on any other entities or individuals. Thereafter on January 5, 1988, following a hearing on damages they obtained a default judgment against Cushman on their securities fraud claims in the United States District Court for the Western District of Texas, Midland-Odessa Division for their original investment and attorney's fees, being a total of $445,400.73.

Shortly before commencement of the Luster group's securities fraud suit in the Western District of Texas, one of the entities involved in the fraudulent venture, Knightsbridge Petroleum Corporation, filed a voluntary petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Texas, Ft. Worth Division. The Luster group timely filed a proof of claim in the Knightsbridge Petroleum Corporation bankruptcy and a motion for relief from the automatic stay in order to proceed against Knightsbridge Petroleum Corporation for securities fraud claims. The Luster group promptly determined that there was no prospect for a reorganization or recovery of funds from Knightsbridge Petroleum Corporation, dismissed their motion for relief from the automatic stay and participated no further in the Knightsbridge Petroleum Corporation bankruptcy. Contemporaneously they dismissed their claims against Knightsbridge Petroleum Corporation in the securities fraud suit pending in the United States District Court for the Western District of Texas, Midland-Odessa Division, but continued action against other related entities and individuals.

The Luster group also engaged in over two years of post judgment action against Cushman seeking to enforce the

judgment awarded in the Western District Court. During such time and without the Luster group's participation or knowledge, a plan of reorganization was confirmed on March 9, 1988 by an order of the Bankruptcy Court for the Northern District of Texas, Fort Worth Division. Among its extensive provisions, the plan contained a clause purporting to release, along with the debtor Knightsbridge Petroleum Corporation, "its present and former officers, directors, employees, (and) agents ... from claims of creditors and stockholders." Despite the existence of the confirmed plan, Cushman never availed himself of the above quoted provision during the post judgment enforcement actions undertaken by the Luster group.

Subsequently, and more than 2 years after rendition of the Western District judgment against him, Cushman filed on March 13, 1990 an individual bankruptcy case in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. The Luster group timely filed a complaint to determine dischargeability seeking to prevent discharge of the $445,400.73 judgment based on actual fraud under Title 11 U.S.C. 523(a)(2)(A), specifically solicitation of funds in violation of federal securities laws. Upon trial of the adversary proceeding in United States Bankruptcy Court for the Northern District of Texas, Dallas Division on July 17, 1991, Cushman asserted for the first time that confirmation of the Knightsbridge Petroleum Corporation plan of reorganization operated as *res judicata* and barred relitigation of the Luster group's fraud claims.

THE RULINGS BELOW

The Bankruptcy Court for the Northern District of Texas, Dallas Division dismissed the Luster group's complaint based entirely upon the authority of *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987). The

trial court's opinion expressly states that the order confirming the plan of reorganization in the Knightsbridge Petroleum Corporation bankruptcy operated as *res judicata* and prevented relitigation of the Luster group's claims. The trial court expressly found that "The release of Cushman by the Knightsbridge confirmed plan exceeds the scope of a discharge under 11 U.S.C. 524." Appendix C. It ruled, however, that the Luster group had an opportunity to object to the plan based upon certain certificates of service from the Knightsbridge Petroleum Corporation bankruptcy case, and that upon failure to do so, became bound by the confirmed plan. The record in the trial court contains no evidence that the Luster group actively participated in the Knightsbridge Petroleum Corporation bankruptcy or received any consideration for the release of the officers, directors or agents of Knightsbridge.

The Luster group appealed the dismissal of the dischargeability complaint to the United States District Court for the Northern District of Texas, Dallas Division. While the District Court noted that the Luster group had produced evidence that it did not receive the order confirming the plan, it held that the trial court's findings of fact and conclusions of law were not contrary to law, nor clearly erroneous nor an abuse of discretion and under the authority of the *Shoaf* case affirmed the judgment of the trial court. An appeal to the Fifth Circuit by the Luster group on the same points raised in the District Court resulted in a per curiam decision from the Court of Appeal that "This Court is compelled to follow *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987)." Appendix A.

The trial court did not reach the merits of the dischargeability complaint and in its opinion did not find significant, indeed did not even mention, that the judgment to be enforced was based upon Cushman's actual fraud in

soliciting funds in violation of federal securities laws and thus was prima facie nondischargeable under *Grogan v. Garner*, -- U.S.--, 111 S.Ct. 654, 112 L.Ed.2d. 755 (1991).

REASONS FOR GRANTING THE WRIT
I.

Certiorari Should Be Granted to Resolve Conflicts in Principle Among the Lower Courts.

The issue here recently has been recognized as having produced a conflict among the lower courts. In *Federal Deposit Ins. Corp. v. O'Donnell*, 136 B.R. 585 (D.D.C. 1991) the court stated: "The Court is aware that the federal courts of appeal are not in agreement on the issue of whether the principle of *res judicata* applies to a bankruptcy court's discharge of the liability of a non-debtor." The District Court for the District of Columbia further noted that "this Circuit has not directly addressed this issue." *Id.* at 589. The court then discussed the two conflicting lines of authority typified by *Union Carbide Corp. v. Newboles*, 686 F.2d 593 (7th Cir. 1982) which refused to give *res judicata* effect to an order of confirmation releasing a non-debtor and *Republic Supply Co. v. Shoaf* which did give *res judicata* effect to an order of confirmation releasing a non-debtor. This conflict among the circuits continues to create confusion and uncertainty and raises the opportunity for wholesale evasion of the dischargeability provisions of the bankruptcy code of substantial amounts of fraudulent debt.

At present the law in the Fifth Circuit concerning release or discharge of guarantors and other nondebtor third parties is based on the Supreme Court decision in *Stoll v. Gottlieb*, 305 U.S. 165, 59 S.Ct. 134, 83 L.Ed. 104 (1938) and *Republic Supply Co. v. Shoaf*. Although release of

nondebtor third parties is expressly disallowed by § 524(e) of the Bankruptcy Code, in both cases *res judicata* was applied to bar claims by creditors against guarantors purportedly released from liability by confirmed bankruptcy plans. However, both *Stoll* and *Republic Supply* involved the creditors' carefully negotiated release of "nondebtor plan funders" whose payments to the reorganization effort served as consideration for their release and without whose cooperation and funding the reorganization plan would not have been successful. Application of *res judicata* in these cases was consistent with the goal of bankruptcy law to allow honest but unfortunate debtors a fresh start while offering creditors the maximum return possible.

In the present case the Fifth Circuit exceeds the authority of *Stoll* and *Republic Supply* by holding that even debts incurred by fraud on the part of a nondebtor are subject to release by a confirmed bankruptcy plan under the principle of *res judicata*. Contrary to the facts in *Republic Supply*, the creditors here had not bargained for the release of Cushman and had not participated in the bankruptcy proceeding which was given *res judicata* effect. Not only did the Luster group receive no consideration for the release of Cushman, no creditor of Knightsbridge Petroleum Corporation received funds through the confirmed plan.

The Supreme Court has addressed the application of *res judicata* in fraud nondischargeability actions. In *Brown v. Felsen*, 442 U.S. 127, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979), the Court held that *res judicata* should not be applied to prevent a judgment creditor from presenting evidence of fraud at a dischargeability hearing. As the opinion there states: "For the sake of repose, *res judicata* shields the fraud and the cheat as well as the honest person. It is therefore to be invoked only after careful inquiry." *Brown v. Felsen*, 442 U.S. at 132. This Court has also addressed the issue of

collateral estoppel in fraud dischargeability cases. In *Grogan v. Garner*, supra, Justice Stevens' opinion clarifies that collateral estoppel principles apply in discharge exception proceedings pursuant to § 523(a). The opinion states that "all fraud claims (which) creditors have successfully reduced to judgment" will be excepted from discharge. *Grogan v. Garner*, 111 S.Ct. at 661. Proper application of *Grogan* would have avoided the successive levels of needless litigation which that decision sought to avoid. Instead, the bankruptcy trial court's disregard of both the securities fraud judgment rendered by the United States District Court for the Western District of Texas and this Court's decision in *Grogan v. Garner* has obligated petitioners to pursue a dischargeability complaint and four subsequent appeals, all following several years of post judgment action in which Cushman never raised the defense of *res judicata*.

The potential for abuse should the rule of *Republic Supply Co. v. Shoaf* be applied to debts procured by fraud is enormous. According to the Texas State Securities Board there are presently 157 criminal indictments for oil and gas fraud in Dallas county alone, many if not most, with related civil fraud and bankruptcy actions. The present decision insures that a fraudulent promoter can obtain a release from personal liability without filing a bankruptcy personally. He need not be named individually but only included in a class released by a confirmed plan of reorganization filed by some other person or entity, ostensibly with ties to the fraudulent scheme.

The rule applied in *Republic Supply* and followed by the Fifth Circuit is in direct conflict with the rule followed by other courts of appeal. The majority of decisions hold that under § 524(e) of the Bankruptcy Code a third party release contained in a plan of reorganization is void, irrespective of confirmation of the plan. *Union Carbide*

Corp. v. Newboles, 686 F.2d 593 (7th Cir. 1982); *Underhill v. Royal*, 796 F.2d 1426 (9th Cir. 1985); *Frank v. Daley (In re Daley)*, 776 F.2d 834 (9th Cir. 1985), *cert. denied*, 476 U.S. 1159, 106 S.Ct. 2279, 90 L.Ed.2d 721 (1986); *United States v. Gurwitch (In re Gurwitch)*, 794 F.2d 584 (11th Cir. 1986); *In re Sago Palms Joint Venture*, 39 B.R. 9 (Bkrtcy. S.D.Fla. 1984). See also *R.I.D.C. Industrial Development Fund v. Snyder*, 539 F.2d 487 (5th Cir. 1976), *cert. denied*, 429 U.S. 1095, 51 L.Ed.2d 542 (1977).

In *Union Carbide Corp. v. Newboles*, supra, the Seventh Circuit held that although a creditor had approved a plan of reorganization in bankruptcy which released a guarantor of the creditor's debt, the same creditor could enforce the guaranty since the bankruptcy court's order confirming the plan of reorganization as to the guarantor was outside its authority and had no effect. The Seventh Circuit expressly refused to give *res judicata* effect to a bankruptcy court order beyond its authority, instead holding that Section 524 of the bankruptcy code controlled. The court stated the majority view that "[a] bankruptcy discharge arises by operation of federal bankruptcy laws, not by contractual consent of the creditors. A creditor's approval of the plan cannot be deemed an act of assent having significance beyondthe confines of the bankruptcy proceedings, simply because the gamesmanship imported from state contract law into the bankruptcy proceedings would be intolerable ..." 686 F.2d at 595.

Both *Stoll* and *Republic Supply* involved the creditors' carefully negotiated release of nondebtor plan funders whose payments to the reorganization effort served as consideration for their release and without whose cooperation and funding the reorganization plan would not have been successful. In the case at hand Cushman's release was in no way bargained for by the creditors, nor of any benefit to creditors, nor an

"integral part" of the reorganization plan in the sense defined by *Republic Supply*. Contemporaneously, another panel of the Fifth Circuit held that where a secured creditor's claim was purportedly eliminated by a confirmed Chapter 13 plan, *res judicata* would apply to that creditor only if the debtor had filed an objection to the claim. *Sun Finance Company, Inc. v. Howard (Matter of Howard)*, 972 F.2d 639 (5th Cir. 1992). In essence, the *Howard* opinion requires that creditors be involved in negotiating the plan and be given specific notice.

CONCLUSION

If allowed to stand the ruling in the case at bar will present an intolerable burden for creditors far in excess of that imposed by the dischargeability provisions of the Bankruptcy Code. It would require that a judgment creditor not only plead and prove a dischargeability complaint in an adversary proceeding but also scrutinize the disclosure statements and plans of reorganization in every bankruptcy case filed by any person or entity ostensibly connected with the fraudulent venture giving rise to his claim. The fraudulent fund raising activities of Walter Humbert Cushman, III in this case covered 37 states and involved scores of fund solicitors. Thousands of investors were approached and hundreds swindled. It is unknown whether other bankruptcy cases were filed by other responsible participants in the ventures or whether plans of reorganization were confirmed purporting to release classes of persons or entities against whom the investors may have claims. The result of the lower court rulings is egregious. A United States District Court judgment for $445,000.00 for securities fraud against a felon convicted of federal mail and wire fraud has been discharged through a bankruptcy in which he was not the debtor. Not only will this case permit the discharge of a fraudulent debt, but the continued

misapplication of the principle of *res judicata* to authorize release of non-debtors through orders confirming plans of reorganization in bankruptcy will permit the wholesale circumvention of the dischargeability provisions of the Bankruptcy Code. Petitioners, therefore, respectfully pray that their petition for *writ of certiorari* be granted.

Respectfully submitted,

_____

Woodrow Epperson
Attorney for Petitioners

PROOF OF SERVICE

I hereby certify that true and correct copies of the foregoing Petition for Writ of Certiorari have been served upon the parties listed below by United States First Class Mail, postage prepaid, this _____ day of _____, 1992, addressed as follows:

Mr. Philip I. Palmer, Jr.
1201 Main Street
Suite 1510
Dallas, Texas 75202

_____
Woodrow Epperson

APPENDIX A

U.S.COURT OF APPEALS
FILED
AUG 27 1992
GILBERT E. GANUCHEAU
CLERK

IN THE UNITED STATES COURT OF APPEAL
FOR THE FIFTH CIRCUIT

NO. 91-7382

IN THE MATTER OF:
WALTER HUMBERT CUSHMAN, III
Debtor

R.E. LUSTER, ET AL.

Appellants,

versus

WALTER HUMBERT CUSHMAN, III

Appellee.

Appeal from the United States District Court
for the Northern District of Texas
(CA 3-91-1897-T)

Before JONES and WIENER, Circuit Judges, and WALTER*, District Judge.

PER CURIAM: **

This Court is compelled to follow *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987).

Accordingly, as to all issues raised by the appellant, the judgment of the district court is *AFFIRMED*.

---

*District Judge of Western District of Louisiana, sitting by designation.

** Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the court has determined that this opinion should not be published.

APPENDIX B

U.S. DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FILED
DEC 12 1991
NANCY DOHERTY, CLERK
BY _____
Deputy

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

R.E. LUSTER, et al.,
Appellants,

v. CA 3-91-1897-T

WALTER HERBERT CUSHMAN III
Appellee,

ORDER AFFIRMING BANKRUPTCY COURT'S RULING

On October 7, 1991, Appellants, R.E. Luster, et al., filed their opening brief. On November 4, 1991, Appellee, Walter Cushman III, filed his response brief, which also asserted a cross-appeal.

Background

This case is before the court on appeal from United States Bankruptcy Judge Steven A. Felsenthal's July 23, 1991 memorandum opinion and order, and August 7, 1991

final order, issued in adversary proceeding 390-3304 in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division.

In early 1990, Appellee Cushman filed his voluntary petition under Chapter 7 of the United States Bankruptcy Code. Thereafter, Appellants commenced this adversary proceeding in the bankruptcy court on May 14, 1991, by filing a complaint to determine dischargeability of debt under section 523 of the Bankruptcy Code.

ORDER AFFIRMING BANKRUPTCY COURT'S RULING
(illegible)
PURSUANT
TO F.R.C.P. RULES
58 AND 79 a.

On January 5, 1988, Appellants obtained a default judgment in the United States District Court for the Western District of Texas against Cushman. The judgment is in the principal amount of $404,909.73, plus attorneys' fees of $40,491.00, all to bear interest at the rate of 10% per annum until paid. Between 1986 and April 27, 1987, Cushman had been the chief executive officer and principal owner of Knightsbridge Petroleum Corporation, Inc. On May 1, 1987, Knightsbridge filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in this district, Fort Worth Division. Appellants filed a complaint against Knightsbridge and Cushman based on investments made with Knightsbridge. Appellants, by their attorney Woodrow Epperson, filed a proof of claim in the Knightsbridge case based on the transactions that gave rise to the default judgment against Cushman. Epperson filed a notice of appearance on behalf of Appellants in the Knightsbridge case.

On March 9, 1988, the Unites States Bankruptcy Court for the Northern District of Texas, Fort Worth Division, entered an order confirming a plan of reorganization as modified, for Knightsbridge Petroleum Corp., Inc. The plan as confirmed released Knightsbridge's former officers and directors, including Cushman, from any claims of creditors and stockholders. In the present proceedings, Judge Felsenthal determined that, by virtue of their proof of claim filed in the Knightsbridge case, Appellants constituted creditors of Knightsbridge and claims they have against Cushman based on their transactions with Cushman and Knightsbridge were released by the confirmed plan.

Judge Felsenthal concluded that the release of Cushman by Knightsbridge's confirmed plan exceeded the scope of a discharge under 11 U.S.C. § 524, but that by failing to object to the plan and appeal the order confirming the plan, Appellants became bound by the confirmed plan. Judge Felsenthal found that Appellants had the notice required by Bankruptcy Rule 2002 of the confirmation hearing, the time for filing ballots accepting or rejecting the plan, and the time for objecting to the plan, and that, therefore, Appellants were put on notice that Knightsbridge's proposed plan would release Cushman from any liability stemming from transactions with Appellants.

Appellants produced evidence that their counsel did not receive the order confirming the plan, and that this was why they did not appeal the order confirming the plan. Judge Felsenthal concluded that, pursuant to Bankruptcy Rule 8002, the time for appeal runs from the date of the entry of judgment, and that an aggrieved party has the duty of monitoring the court record for entry of the order. Judge Felsenthal further concluded that, not having filed a written objection nor having appeared at the confirmation hearing to

object to the plan, Appellants would not be aggrieved parties having standing to appeal the order confirming the plan.

Judge Felsenthal concluded that he was bound by the order confirming Knightsbridge's plan that released Cushman from liability, that Cushman's liability on the default judgment entered on January 5, 1988, was released, and that Appellants' complaint seeking to declare that default judgment not discharged had to be dismissed.

Discussion

Jurisdiction and Standard of Review

The court finds that the decision entered by the bankruptcy court is a final decision and properly appealable to this court under 28 U.S.C. § 158 and Bankruptcy Rule 8001, and finds that it has jurisdiction over the matters in this case under 28 U.S.C. § 1334.

Pursuant to Bankruptcy Rule 8013, the findings of fact of the bankruptcy court are reviewed under a clearly erroneous standard. *Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir. 1986).

Issues Presented

The issues presented on appeal are:

1) Whether the bankruptcy court's judgment in favor of Cushman should be reversed because, as a matter of law, Appellants' complaint under 11 U.S.C. § 523(a)(2)(A) is not subject to a plea of res judicata?

2) Whether Cushman is barred from asserting the

plea of res judicata by failing to affirmatively plead this defense?

3) Whether the judgment in favor of Cushman should be reversed because Appellants received no actual notice of the order confirming the plan of reorganization in the Knightsbridge bankruptcy?

(4) Whether Appellants are charged with notice of the order confirming Knightsbridge's plan of reorganization?

(5) Whether the judgment in favor of Appellants against Cushman precludes relitigation of the issue of fraud under 11 U.S.C. § 523(a)(2)(A) in an adversary proceeding in the United States Bankruptcy Court?

(6) Whether the provision in the Knightsbridge plan of reorganization purporting to release "present and former officers, directors, employees, agents" collaterally estops judgment creditors of Cushman from asserting a fraud dischargeability action against Cushman under 11 U.S.C. § 523(a)(2)(A)?[1]

After considering the record provided to the court, the briefing of the parties, and the applicable case law and statutory authority, the court is unable to conclude that the bankruptcy court's findings of fact and conclusions of law in its July 23, 1991 memorandum opinion and order are contrary to the law, are clearly erroneous, or constitute an

---

1. The issues presented in this order are those of Appellants, Luster, et al. Appellee Cushman has asserted a cross-appeal. However, the issues raised in Cushman's appeal were made contingent on this court's reversal or modification of the bankruptcy court's order. As the court affirms the bankruptcy court, it will not address Cushman's issues on appeal.

abuse of discretion.

The record provides sufficient evidence to support each of the bankruptcy court's findings of fact. Further, each of the bankruptcy court's legal conclusions is supported by the law. The court has reviewed *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987), on which the bankruptcy court relied in determining that Appellants' claim was barred by res judicata.

It is therefore ORDERED that the bankruptcy court's July 23, 1991 memorandum opinion and order, and August 7, 1991 final order entered in adversary proceeding 390-3304 are affirmed.

SIGNED on the 11th day of December 1991.

/s/ Robert B. Maloney

Robert B. Maloney
U.S. District Judge

ORDER AFFIRMING BANKRUPTCY COURT'S RULING

APPENDIX C

ENTERED
JULY 23 1991
UNITED STATES
BANKRUPTCY COURT
NORTHERN DISTRICT
OF TEXAS
MICHAEL W. YOUDIN,
CLERK

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§
	§
WALTER HUMBERT CUSHMAN, III,	§ CASE NO. 390- § 31677-SAF-7
	§
_____	§
	§
R.E. LUSTER, BERNARD F. ARENAS, III, DAVID K. CARGILL, ELMER V. CLAPS, JAMES P. COLE, DAVID E. DODRILL, DR. JOHN DRAMMIS, JR., DONALD F. and MARGARET M. GARRETT, RICHARD W. and RUTH M. HAACK, BRADLEY O. HOLM, L.I. INVESTMENT CLUB TRUST #3, DR. READ LEWIN, DR. BARRY J. and LINDA L. KRAYNACK,	§

WOODROW S. PATTERSON,	§	
KENNETH L. SALSMAN,	§	
REBECCA THOMPSON,	§	
THEODORE R. THOMPSON,	§	
PAUL TILLOTSON, GEORGE	§	
and VIRGINIA L. UDALL,	§	
CHARLES D. WARREN, B.E.	§	
WEBB, FRANK L. WEY, and	§	
JOHN V. ZEMAN,	§	
PLAINTIFFS,	§	
	§	
VS.	§	ADVERSARY NO.
	§	390-3304
WALTER HUMBERT,	§	
CUSHAM, III,	§	
DEFENDANT.	§	

MEMORANDUM OPINION AND ORDER

R. E. Luster, et al. (Luster) object to the discharge of a debt based on a default judgment entered in the United States District Court for the Western District of Texas on January 5, 1988. Luster complains that the debt must be excepted from discharge under §§ 523(a)(2)(A) and (a)(6) of the United States Bankruptcy Code. The court conducted a trial on the complaint on July 17, 1991. Determination of the dischargeability of a particular debt is a core matter over which this court has jurisdiction to enter a final judgment. 28 U.S.C. § 157(b)(2)(I) and § 1334. This memorandum opinion contains the court's findings of fact and conclusions of law required by Bankruptcy Rule 7052.

On January 5, 1988, Luster obtained a default judgment in the United States District Court for the Western District of Texas against the debtor Walter H. Cushman.

The judgment is in the principal amount of $404,909.73 plus attorneys fees of $40,491.00, all to bear interest at the rate of 10% per annum until paid. Between 1986 and April 27, 1987, Cushman had been the chief executive officer and principal owner of Knights Bridge Petroleum Corp. Inc. On May 1, 1987, Knights Bridge filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in this district, Fort Worth Division. Luster filed a complaint against Knights Bridge and Cushman based on investments made with Knights Bridge. Luster by their attorney Woodrow Epperson of Houston filed a proof of claim in the *Knights Bridge* case based on the transactions that gave rise to the default judgment against Cushman. Epperson filed a notice of appearance on behalf of the plaintiffs in the *Knights Bridge* case.

The default judgment against Cushman establishes liability on a claim for purposes of Cushman's Chapter 7 bankruptcy case.

On March 9, 1988, the United States Bankruptcy Court for the Northern District of Texas, Fort Worth Division, entered an order confirming a plan or reorganization, as modified, for Knights Bridge Petroleum Corp. Inc. The plan as confirmed released Knights Bridge's former officers and directors, including Cushman, from any claims of creditors and stockholders. By virtue of their proof of claim filed in the *Knights Bridge* case, the Luster group constituted creditors of Knights Bridge. Claims that they have against Cushman based on their transactions with Cushman and Knights Bridge were released by the confirmed plan.

The release of Cushman by Knights Bridge's confirmed plan exceeds the scope of a discharge under 11 U.S.C. § 524. Nevertheless, if Luster had an opportunity to

object to the plan and an opportunity to appeal the order confirming the plan and failed to pursue those rights, they are bound by the confirmed plan. *See Republic Supply Company v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987).

By stipulation of parties, the court reopened the record following closing to admit exhibit I which is a certificate of service with supporting documents from the *Knights Bridge Petroleum Corp., Inc.* case, The certificate of service reflects that on October 21, 1987, the plaintiffs, individually and through their attorney of record, Woodrow Epperson, were served with notice of the order approving the first amended disclosure statement and fixing the time for filing acceptances or rejections of the plan, for objecting to the plan and for confirmation hearing, and with the first amended disclosure statement containing the Knights Bridge plan. By stipulation of parties, the court has also reopened the record to admit exhibit H which is the order approving the first amended disclosure statement and fixing the time for filing acceptances or rejections of the plan, for objecting to the plan, for the confirmation hearing, and the notice thereof, and exhibits J, K and L, motion, order and notice resetting the confirmation hearing.

These documents from the *Knights Bridge Petroleum Corp., Inc.* Chapter 11 proceedings establish that the plaintiffs had the notice required by Bankruptcy Rule 2002 of the confirmation hearing, the time for filing ballots accepting or rejecting the plan, and the time for objecting to the plan together with an approved disclosure statement containing the proposed plan. The plaintiffs were thereby put on notice that Knights Bridge's proposed plan of reorganization would release Cushman from any liability stemming from their transactions. Luster had filed a proof of claim based on these transactions and had commenced litigation against both Knights Bridge and Cushman, resulting

in the pre-confirmation default judgment against Cushman. The plaintiffs did not object to the Knights Bridge plan containing this release of Cushman. The plaintiffs did not attend the hearing on the confirmation of the Knights Bridge plan.

The plaintiffs did not appeal the final order confirming the modified Knights Bridge plan. At the trial in this adversary proceeding, the plaintiffs introduced evidence that counsel for the plaintiffs did not receive the order confirming the plan. The time for appeal runs from the date of the entry of the judgment. Bankruptcy Rule 8002. An aggrieved party has the burden of monitoring the court record for the entry of the order. Furthermore, not having filed a written objection nor having appeared at the confirmation hearing to object to the plan, Luster would not be aggrieved parties having standing to appeal the order in any event.

Luster thereby permitted the plan releasing Cushman from liability on a debt to them to be confirmed by the bankruptcy court without objection and without appeal. That order is therefore binding on this court. *See Republic Supply v. Shoaf, id.*

Consequently, Cushman's liability on the default judgment entered January 5, 1988, is released by the order confirming the Knights Bridge plan. This complaint seeking to declare that default judgment not discharged by Cushman's bankruptcy proceeding must therefore be dismissed.

Plaintiffs attempt to distinguish *Shoaf*. Contrary to their contentions, however, the *Knights Bridge* record introduced in evidence in this case supports applying the *Shoaf* ruling. Luster received a second bite of the apple in the bankruptcy court in the *Knights Bridge* case. A creditor

filed a motion to convert the *Knights Bridge* case post-confirmation to a case under Chapter 7 of the Bankruptcy Code. The motion was served on Luster through their counsel of record. The official committee of working interest owners responded to the motion by urging the bankruptcy court not to alter the substantive effect of the order confirming the plan. Luster did not file a response to that motion. The bankruptcy court entered an order on February 5, 1991, converting the case to a case under Chapter 7 but specifically provided that the orders identified by the official committee of working interest owners would not be affected by the conversion. Luster had an opportunity through the motion to convert to seek relief from the order confirming the plan. They failed to do so. The order converting the case but preserving the effectiveness of the order confirming plan is now final and binding.

Luster asserts that because the plaintiffs withdrew their motion for relief from the automatic stay in the *Knights Bridge* case they should be deemed to have removed themselves from that case so as not to be bound by *Shoaf*. The withdrawal of the motion for relief from the automatic stay is *irreverent* (sic) to *Shoaf*. They filed a proof of claim in the *Knights Bridge* case based on the substantive transactions that gave rise to their default judgment against Cushman. They were duly served with the required notices of the confirmation hearing and the time to object to the plan together with the disclosure statement and the plan. They failed to object to the plan. They failed to appeal the order confirming the plan. *Shoaf* governs.

Based on the foregoing,

IT IS ORDERED that the complaint is **DISMISSED** with prejudice. Counsel for Cushman shall prepare a final order consistent with this memorandum opinion and order.

Dated this 23rd day of July, 1991.

/s/ Steven A. Felsenthal
Steven A. Felsenthal
United States Bankruptcy Judge

APPENDIX D

FILED
JAN 05 1988
U.S. DISTRICT COURT
CLERK'S OFFICE
BY /s/ illegible DEPUTY

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
MIDLAND - ODESSA DIVISION

R. E. LUSTER, BERNARD F. ARENAS, III., DAVID K. CARGILL, ELMER V. CLAPS, JAMES P. COLE, DAVID E. DODRILL, DR. JOHN DRAMMIS, JR., DONALD F. and MARGARET M. GARRETT, RICHARD W. and RUTH M. HAACK, BRADLEY O. HOLM, L. I. INVESTMENT CLUB TRUST #3, DR. READ LEWIN, BARRY J. and LINDA L. KRAYNACK, WOODROW S. PATTERSON, KENNETH L. SALSMAN, REBECCA THOMPSON, THEODORE R. THOMPSON, PAUL TILLOTSON, GEORGE and VIRGINIA L. UDALL, CHARLES D. WARREN, B. E. WEBB, FRANK L. WEY and JOHN V. ZEMAN

Plaintiffs

v. CIVIL ACTION NO. MO 87 CA 118

KNIGHTS BRIDGE PETROLEUM, and WALTER H. CUSHMAN

Defendants

DEFAULT JUDGMENT

On this day came on for hearing the captioned cause and it appearing to the Court that Defendant Walter Humbert Cushman was duly served with citation on July 7, 1987 commanding him to appear and answer this action and it further appearing that such Defendant has failed to appear and answer herein and it further appearing that the civil process server's return of the citation served on Defendant Walter Cushman has been heretofore filed with the Clerk of this Court and it further appearing that Plaintiffs are entitled to a judgment by default against Defendant Walter Humbert Cushman by reason of the failure of such Defendant timely to appear and answer herein; now therefore it is:

ORDERED, ADJUDGED and DECREED that Plaintiffs R. E. Luster, Bernard F. Arenas, III., David K. Cargill, Elmer V. Claps, James P. Cole, David E. Dodrill, Dr. John Drammis, Jr., Donald F. and Margaret M. Garrett, Richard W. and Ruth Haack, Bradley O. Holm, L. I. Investment Club Trust #3, Dr. Read Lewin, Barry J. and Linda L. Kraynack, Woodrow S. Patterson, Kenneth L. Salsman, Rebecca Thompson, Theodore R Thompson, Paul Tillotson, George and Virginia L. Udall, Charles D. Warren, B. E. Webb, Frank L. Wey and John V. Zeman have judgment against Defendant Walter Humbert Cushman in the amount of $404,909.73, that they have their reasonable attorney's fees in the amount of $40,491.00, and their costs all such sums to bear interest at the rate of 10% per annum until paid.

SIGNED this 5th day of January, 1988.

/s/ Lucius D. Bunton
UNITED STATES DISTRICT JUDGE

APPROVED AS TO FORM:

/s/ Woodrow Epperson
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(2)

Supreme Court, U.S.
FILED
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No. 92-1282

In The

Supreme Court of the United States

October Term, 1992

R. E. LUSTER, BERNARD F. ARENAS, III, DAVID K. CARGILL, ELMER V. CLAPS, JAMES P. COLE, DAVID E. DODRILL, DR. JOHN DRAMMIS, JR., DONALD F. AND MARGARET M. GARRETT, RICHARD W. AND RUTH M. HAACK, BRADLEY O. HOLM, L. I. INVESTMENT CLUB TRUST #3, DR. READ LEWIN, DR. BARRY J. and LINDA L. KRAYNACK, WOODROW S. PATTERSON, KENNETH L. SALSMAN, REBECCA THOMPSON, THEODORE R. THOMPSON, PAUL TILLOTSON, GEORGE and VIRGINIA L. UDALL, CHARLES D. WARREN, B. E. WEBB, FRANK L. WEY, and JOHN V. ZEMAN,

Petitioners,

v.

WALTER HUMBERT CUSHMAN, III,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE

The facts relevant to consideration of the Petition for Certiorari are found in the opinion of the Bankruptcy Judge (Appendix C, Pet. Cert.). Arranged in chronological order they are:

1986 – April 27, 1987 –

Knightsbridge Petroleum Corporation ("Knightsbridge") sold various mineral interests to the Petitioners at a time when Respondent was its chief executive officer.

May 1, 1987 –

Knightsbridge filed for reorganization under Chapter 11. Petitioners are all scheduled as claimants in that proceeding.

July 7, 1987 –

Petitioners served Respondent in a separate action for damages. Knightsbridge was an unserved defendant.

1987 –

Petitioners filed a Motion to Lift Stay in the Bankruptcy Court for permission to continue their suit against Knightsbridge, but later withdrew the Motion.

Petitioners filed their Proofs of Claim in the Knightsbridge reorganization proceeding.

October 21, 1987 –

Knightsbridge served upon Petitioners and their attorney the Disclosure Statement, the proposed Plan of Reorganization, the Order Approving

the Disclosure Statement and Setting the Deadlines for Objection to Confirmation.

January 5, 1988 –

Petitioners took a Default Judgment against Respondent, but filed nothing further in the reorganization proceeding.

March 9, 1988 –

The Bankruptcy Judge confirmed the Plan of Reorganization. Despite their prior service and knowledge, Respondents did not vote, did not object to the Plan of Reorganization, and did not object to the confirmation.

March 13, 1990 –

Respondent filed his individual bankruptcy proceeding.

The statement of the case as given by the Petitioners contains a considerable quantity of factual allegations about the Respondent, obviously intended to disparage him, but which are simply not in the record. While it is true these unproved allegations are not important to the issue before the Court, still Respondent wants it to be known that he does not concede these unproven allegations.

SUMMARY OF ARGUMENT

There is just no split between the circuits. All Petitioners have located is a District Court opinion stating that there is a division of authority.

To the contrary, it is well established that third party releases in Plans of Reorganization are improper. Nevertheless, if parties with knowledge do not timely object so that a judgment of confirmation is entered, those parties will thereafter be bound by the judgment under standard principles of res judicata claim preclusion.

ARGUMENT

The principles of claim preclusion (res judicata) and the fact that an Order confirming a Plan of Reorganization is a judgment are all well established by prior opinions of this Court.

It is also well established that a Plan of Reorganization cannot release third parties, at least absent very unusual circumstances not present here. What happens, however, if the Plan of Reorganization contains such a third-party release, which could have been the basis of an objection, but no such objection was ever made and the Plan was confirmed? Does res judicata now apply or is the judgment subject to collateral attack?

All authorities concur that res judicata does indeed prevent collateral attack. What Petitioners really present to this Court is not a conflict between the circuits, but a District Court opinion which, in the process of finding claim preclusion, remarks that there is a conflict between the circuits. *F.D.I.C. v. O'Donnell,* 136 B.R. 585, 589 (D. D.C. 1991).

The two cases cited in that opinion do not support the conclusion of a conflict. To the contrary, they are

easily distinguishable. In *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985), the creditors objected to the release provisions of the Plan before it was confirmed. By stipulation, the issue of validity of the release was left for determination by the District Court of a pending class action. This case, then, only supports a proposition not in issue, namely, that a third-party release is not proper in a Plan of Reorganization and is vulnerable to attack before judgment of confirmation is entered.

The case of *Union Carbide Corp. v. Newboles*, 686 F.2d 593 (7th Cir. 1982), involved a plan of arrangement under Chapter XI of the Bankruptcy Act of 1898. The issue there presented to the Court of Appeals was whether the acceptance of a 20 percent dividend from a corporate debtor worked an accord and satisfaction of the individual guarantor under the state law of Indiana.

While the District Judge cited no additional authorities to support the conflict, Petitioners here add *In re Gurwitch*, 794 F.2d 584 (11th Cir. 1986) and *In re Daley*, 776 F.2d 834 (9th Cir. 1985). The first case does not present an issue of a third-party release, but whether the Internal Revenue Service may amend so as to increase its claim against the debtor himself after confirmation. The second case did not involve confirmation or even a reorganization. It dealt instead with a totally different area. The issue there concerned the preclusionary effect of a pre-bankruptcy lawsuit upon the right to object to the debtor's discharge in a later Chapter 7 proceeding. This Court has already explored that subject in depth in *Brown v. Felsen*, 442 U.S. 127 (1979).

There is nothing new or startling in the proposition that claimants, even with meritorious claims, may find themselves barred when they slumber upon their rights. The petition presents neither an important question nor a conflict between circuits requiring resolution.

CONCLUSION

The Petition for Certiorari should be denied.

Respectfully submitted,

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